Maximizing Value From Shifting Acquirer Interest

Large Acquirers Focused on Smaller Acquisitions

by Joe Sands
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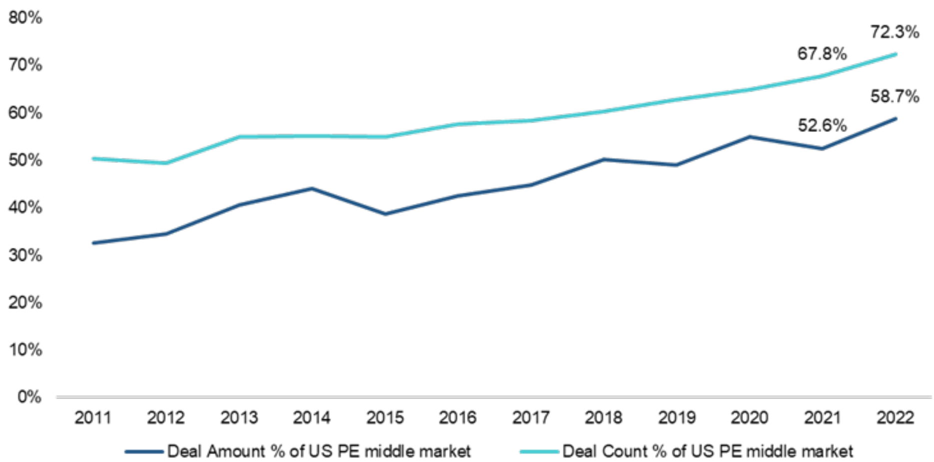
The economic cycle is changing with a potential recession in the making. Some trends are changing in the M&A market as a result. Although, a deep recession is unlikely, as too many talking heads, pundits and media outlets have been saying the "R-word" for too long and one thing I know after 30 years in this business is that when everyone is forecasting the same thing, it usually doesn't happen.

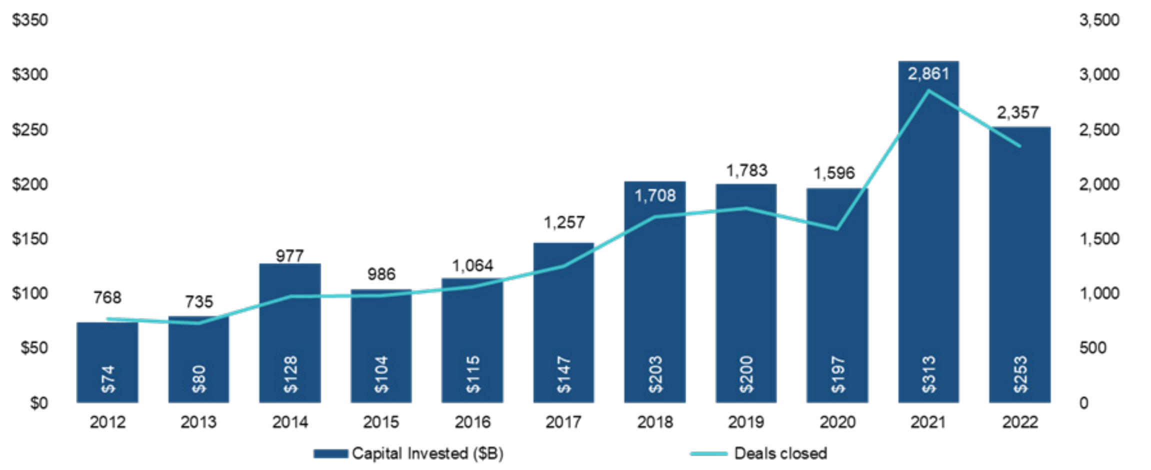
We have been seeing clients and other businesses making significant adjustments in their business in preparation for a recession, so they should weather it well; thus, in the aggregate muting or mitigating the overall macro recession scenario. We can all debate either side of recession probability and severity, in either case, there are some clear trends taking shape that bode well for the lower middle market - - "Add-Ons" are in vogue.

For those unfamiliar with the term, "Add-Ons" are acquisitions of a small company by a much larger company. Typically, they are anywhere from 1-10% of the revenues of the acquirer. In other words, much smaller acquisitions than the acquirer would normally undertake. For example, a $200 million company would normally look at acquisitions representing 10-40% of their current size or larger. Other names related to an Add-On include "Tuck-Ins" or "Bolt-Ons". Because these acquisitions are much smaller, they are generally deemed less risky to the acquirer, easier to integrate with their existing operation, able to realize synergies, and provide an alternative or additional means to grow their top and bottom line when the overall economy or the existing business is flat or declining.

Add-ons As A Share of US Middle Market PE Deal Flow (Source: Pitchbook)



US Middle Market PE Deal Activity (Source: Pitchbook)



What's driving this trend? - - the acquisitions made by private equity groups over the past few years typically occurred at very high valuations, using large amounts of debt and they now need to rationalize those investments by 'adding on' smaller acquisitions at lower multiples (smaller companies have lower multiples, ceteris paribus) with revenue and cost synergies to get the overall aggregate valuation normalized. They are in a sense averaging down their overall price paid. Add-Ons are common in good times as well, dubbed "buy & build strategies". Now, as economic forecasts are looking a bit more dismal and projections that were relied upon to close past deals are not likely to be achieved, acquirers are scrambling to do everything they can to prepare their portfolio companies for a recession. An Add On acquisition strategy is one of the important and most impactful strategies to meet growth goals in today's market.

Therefore, in an economic downturn, high quality, smaller deals can command a lot of attention and even a premium valuation depending on the industry. This is an opportunity for businesses with $3-50 million in revenues considering a partial or full sale of their business. Comprehensive exit strategy plans together with ready shareholders/owners can get more attention in today's market than a typical or even hot market, as acquirers are motivated to quickly rationalize their bloated premiums paid for the larger businesses over the past few years.

Strategic Considerations for Maximizing Value:

1. Smaller companies that are between $3 million and $50 million in sales regardless of their EBITDA should become more comfortable including larger private equity groups that already have portfolio companies in the same industry in their potential buyer universe. In addition, approaching larger strategics in a sale process is appropriate as most larger businesses will be seeking growth through acquisition.
2. Selling owners are likely to be able to exit their day-to-day operating role much quicker as the acquirer is fully staffed and already operating in the industry.
3. Valuation negotiations should take into consideration likely post-acquisition synergies.
4. Strategic acquirers have industry knowledge and experience, which should make negotiations, due diligence and post-acquisition integration much smoother.
5. Rollover equity is negotiable and shouldn't be a 'must'.
6. Post transaction layoffs are likely in areas of duplication like admin, accounting, HR and I/T.

7. Stability for the benefit of shareholders, customers, vendors, employees is addressed now that the exit transaction has been executed.

In summary, there is greater interest in smaller acquisition targets by large institutional and strategic acquirers. Anecdotally, the number of calls we are receiving from clients and other advisors in response to calls they are receiving from potential acquirers is trending very high. For further information and insights or to discuss a particular case email me at jsands@cfaw.com.

About the Author

Joe Sands is an investment and merchant banker with over 25 years of experience in mergers & acquisitions, capital raises and strategic advisory services. He is a Managing Director at Corporate Finance Associates, a 65-year-old global middle market investment banking firm, where he serves as the head of the Consumer and Multi Unit Retail Practice Group. Joe also serves on several other industry practice groups at the firm including transportation, industrial, energy and healthcare. Over the course of his career, Joe has completed dozens of transactions across multiple industries, aggregating several billion dollars of transaction value. He has also been an owner/operator of four middle market businesses over his career, which he exited as a principal. Joe speaks to business groups & associations around the country and authored the Exit Planning Institute's exit planning certification program (CEPA) on Third Party Sales of a Business. Joe can be reached at jsands@cfaw.com.

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